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September 20, 2017

Comptroller of the Currency
C/o Legislative and Regulatory Activities Division,
Office of the Comptroller of the Currency,
400 7th Street, SW., suite 3E-218,
Washington, DC 20219.
c/o regs.comments@occ.treas.gov

Docket ID OCC-2017-0014

Volcker Rule

Dear officers,

On behalf of more than 400,000 members and supporters of Public Citizen, we offer the following comment in response to the request by the Comptroller of the Currency regarding Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, known as the Volcker Rule.

At the outset, we challenge the provenance of this request. The Volcker Rule requires the coordinated efforts of five separate regulatory agencies. Yet this request for comment comes from only one of these agencies. Further, the acting Comptroller has not been subject to nomination and confirmation by the U.S. Senate, as provided by law. Given the momentous nature of the Volcker Rule, we find it injudicious that a caretaker with dubious legal standing would unilaterally seek to dilute one of the key reforms responding the calamities of the financial crisis of 2008.

Further, we protest the tenor of this request. The abiding theme running through this request for comment and specific questions is that Volcker Rule should be diluted. The Comptroller's request for comment is glutted with loaded argument. For example, the notice explains that "some" support the Volcker Rule's results, while "many" assert problems. In fact, "many" support the Volcker Rule, while its critics are essentially limited to industry and its funded consultants.[1] Supporters include former Citigroup CEO John Reed, economists Robert Reich and Robert Johnson, and tens of thousands of citizens who have commented during the rulemaking process.[2] The Comptroller is merely obliging the

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[1] *Proprietary Trading and Certain Interests in and Relationships with Covered Funds (Volcker Rule)* COMPTROLLER OF THE CURRENCY (August 8, 2017) See p. 7, notice and comment, https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-occ-2017-89a.pdf

[2] *Merkley-Levin amendment to crack down on high-risk proprietary trading,* SEN. JEFF MERKLEY (May 10, 2010) https://www.merkley.senate.gov/news/press-releases/merkley-levin-amendment-to-crack-down-on-high-risk-proprietary-trading

Administrative Procedures Act perfunctorily before consummating the Trump administration's stated goal of rolling back this reform.

Finally, the Volcker Rule was designed to protect Americans from the recklessness of Wall Street. As such, it should be average citizens from whom the Comptroller should most want to hear. Yet the questions are designed to be answered largely by Wall Street firms themselves. That's because the Comptroller seeks data on trading and compliance burdens proprietary to Wall Street firms.

Why the Volcker Rule is Important

The Volcker rule, named for former Chairman of the Federal Reserve Paul Volcker, restricts proprietary trading. —when banks and their affiliates make bets to increase their own profits rather than brokering transactions on behalf of clients.[3] The statute also establishes limits on their investments in private equity and hedge funds. Firms may engage in market making, matching customers who are sellers with those who purchase. Federally insured firms may also engage in proprietary trading in US. Treasury securities.

Proprietary trading figured at the center of the financial crisis. Lehman Brothers invested in and traded intensely in mortgage-back securities, leading the largest bankruptcy in history. Bear Stearns also failed when several of its sponsored hedge funds suffered losses in their losses on their collateralized debt obligation (CDO) portfolios.[4] Major bank holding companies such as Bank of America and JP Morgan also traded in high risk products such as CDOs and credit default swaps, leading to major losses.

The Basel Committee on Banking observed in a 2009 report that "Since the financial crisis began in mid-2007, the majority of losses and most of the build-up of leverage occurred in the trading book. [The "trading book" is the accounting for propriety trading.] Losses in many banks' trading books during the financial crisis have been significantly higher than the minimum capital requirements."[5]

Beyond fueling a crisis, proprietary trading drains the economy even in placid times. Observes Prof. Thomas Philippon of New York University, trading has grown in the finance sector, accounting for the growing share of banking in the gross national product. "The finance industry of 1900 was just as able as the finance industry of 2000 to produce bonds and stocks, and it was certainly doing it more cheaply.

[3] *Volcker Rule: Frequently Asked Questions*, FEDERAL RESERVE BOARD, (website visited Sept. 7, 2017) https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm

[4] *The Financial Crisis Inquiry Report*, FINANCIAL CRISIS INQUIRY COMMISSION, (January 2011) fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

[5] *Reducing pro-cyclicality arising from the bank capital framework* JOINT FSF-BCBS WORKING GROUP ON BANK CAPITAL ISSUES (2009), http://www.fsb.org/wp-content/uploads/r_0904f.pdf?page_moved=1

But the recent levels of trading activities are at least three times larger than at any time in previous history." [6]

Proprietary trading means banks are using depositor funds for speculation, not loan-making to grow enterprise. JP Morgan used depositor funds to bet that American Airlines would go bankrupt and pocketed $400 million. Surely, betting on the financial demise of a major American corporation can serve no socially useful purpose.[7]

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act responds to the lessons learned during the crisis by addressing risks associated with combining commercial banking and investment banking. It addresses inherent conflicts of interest and takes a step towards ensuring banking groups engage only in client-focused products and services and traditional activities such as deposit-taking and loan-making. It is based on the simple premise that high-risk betting does not belong in or near institutions with access to the federal "safety net."

This statute and the underlying principle is widely supported, including a bipartisan group of former Treasury secretaries, the Independent Community Bankers of America and dozens of other groups and organizations across of the political spectrum. [8]

Liquidity

Reducing the risk of financial catastrophe and prompting financial institutions to deploy deposits made cheap and abundant by taxpayer-backed Federal Deposit Insurance (FDIC) into socially useful loan-making for enterprise constitute unassailable goals. Financial institutions nevertheless claim the Volcker Rule should be diluted because of harm to liquidity. Liquidity refers to the ability of buyers and sellers to transact with minimal change in price. That liquidity should trump financial stability as a key goal is untenable, even were it true that the Volcker Rule has harmed this metric. Liquidity should not be a key or even major metric. There are times when liquidity actually signals a bubble, as frothy trading can be irrational. The so-called dot-com bubble, when internet stocks reached levels unsupported by fundamentals such as revenue or profit, is one example. More recently, liquidity in the housing market, including traffic in securitizations, also presaged the financial crash of 2008.

But the fact is that liquidity has not been harmed. In the most thorough review of this subject, in a report commissioned by an act of Congress, the Securities and Exchange Commission has assessed the impact of the Volcker Rule on market liquidity. It has reviewed existing studies and augmented these with its own research, availing itself with information that only a government agency can obtain. Its conclusion: Market liquidity remains robust. For example, "In corporate bond markets, trading activity

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[6] Thomas Philippon*, Finance v. Wal-Mart: Why are Financial Services so Expensive*, RUSSELL SAGE ORGANIZATION (website viewed September 5, 2017) https://www.russellsage.org/sites/all/files/Rethinking-Finance/Philippon_v3.pdf

[7] Bartlett Naylor, *TOO Big,* PUBLIC CITIZEN (2016) https://www.citizen.org/sites/default/files/toobig.pdf

[8] *Letter to Treasury Secretary Steven Mnuchin,* SENS. SHERROD BROWN, JEFF MERKLEY (Sept. 7, 2017)

and average transaction costs have generally improved or remained flat. More corporate bond issues traded after regulatory changes than in any prior sample period."[9]

Improving the Volcker Rule

We do believe that enforcement transparency is important. The Volcker Rule is a central element of Wall Street reform, yet the regulators have established no vehicle for reporting on progress. As a result, it is difficult to ascertain whether the rule is enforced with vigor. The evidence that firms have reduced trading is mixed.

On one side of the ledger, the Comptroller of the Currency reports no significant decrease in total trading revenue as a percentage of the gross revenue at the four most active trading banks. It also reports an increase in commodity and equity derivative contracts.[10] As for specific firms, as of 2016, JP Morgan, has only deployed $894 billion to loan-making out of its $1,375 billion in deposits. The balance has been allocated to trading.[11] Some trading has been costly. Goldman lost $100 million in what the Wall Street Journal called a "wrong way bet" on natural gas prices.[12]

On the other side of the ledger, there is some evidence that trading may be subsiding. The Comptroller of the Currency reports a steady decline in the "value at risk" levels of the major banks, in credit derivative contracts, and in so-called level 3 trading assets since the financial crisis. Level 3 assets are those without market prices and where the bank itself assigns a prices.[13] Value at risk is a measure of the total loss a firm could suffer in a worst case scenario. Recently, JP Morgan forecast a decline in trading revenue.[14] Goldman reported that it would reduce reliance on trading revenue in favor of more aggressive loan-making.[15]

To address this lack of clarity, we recommend that regulators publish a number of items to demonstrate the enforcement of the Volcker Rule. We recommend that regulators publish: enforcement actions; data for each individual bank trading desk, (with a delay); details of private equity and hedge fund ownership and activity. With a delay, none of this data would compromise proprietary information. Traders who

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[9] *Report to Congress: Access to Capital and Market Liquidity*, DIVISION OF ECONOMIC AND RISK ANALYSIS, SECURITIES AND EXCHANGE COMMISSION (August 2017) https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf

[10] *Quarterly Report on Bank Trading and Derivatives Activities*, COMPTROLLER OF THE CURRENCY, (First Quarter, 2017) https://www.occ.gov/topics/capital-markets/financial-markets/derivatives/dq117.pdf

[11] JP Morgan 10-k, SECURITIES AND EXCHANGE COMMISSION (2016) https://www.sec.gov/Archives/edgar/data/19617/000001961717000314/corp10k2016.htm#s0ADE49B355ED5DA4852BAB618E8A2865

[12] Liz Hoffman, *Wrong Way Bet Fueled Goldman's Second Quarter Swoon,* WALL STREET JOURNAL, (August 18, 2017) https://www.wsj.com/articles/wrong-way-gas-bet-fueled-goldmans-second-quarter-swoon-1503048600

[13] *Quarterly Report on Bank Trading and Derivatives Activities*, COMPTROLLER OF THE CURRENCY, (First Quarter, 2017) https://www.occ.gov/topics/capital-markets/financial-markets/derivatives/dq117.pdf

[14] Fred Imbert, *JPMorgan CEO Jamie Dimon says bitcoin is a "fraud" that will eventually blow up,* CNBC (September 12, 2017) https://www.cnbc.com/2017/09/12/jpmorgan-ceo-jamie-dimon-raises-flag-on-trading-revenue-sees-20-percent-fall-for-the-third-quarter.html

[15] Dakin Campbell, *Goldman's Trading Turnaround Takes a Back Seat to Lending*, BLOOMBERG (Sept. 12, 2017) https://www.bloomberg.com/news/articles/2017-09-12/goldman-sees-2-5-billion-earnings-opportunities-through-2020

leave one bank for another are paid a "gardening leave" where they do not work for either firm. This period can last as little as four weeks, because the trading positions and strategies are no longer revealing to the new firm at this point. Consequently, publication of firm data after four months or longer would not reveal sensitive information. Publication on quarterly basis, as the Comptroller now does with derivatives trading aggregates, would allow the public to understand better if the Volcker Rule is truly operational. If a trader, who is best positioned and motivated to exploit inside information of a rival firm, can be trusted with four-week old data, then surely the public can be trusted with four month old information.

Misguided Deregulation

Whether or not regulators are enforcing the Volcker Rule forcefully, banks of all sizes are thriving. The banking industry's annual profits reached record highs in 2016, when the industry's net income was $171.3 billion, 4.9% more than in 2015.[16] The ten largest lenders recorded $30 billion in profit in the second quarter of 2017, nearly matching the all-time record established before the financial crisis in 2007.[17]

Surely, a time of financial profit and general economic growth is not time to reverse key reforms, especially with a dilution of the Volcker Rule.

Key regulators warn against relaxing the reforms that have proven key to economy recovery and even to bank prosperity. Regulators warn against diluting the Volcker rule. Thomas Hoenig, vice chair of the Federal Deposit Insurance Corp., contends the Volcker Rule is critical and doesn't harm community banks. "I regularly meet with hundreds of community bankers from around the country, and while they voice major concerns about regulatory burden, the Volcker Rule is not one they highlight."[18] At the annual Jackson Hole retreat, Federal Reserve Chair Janet Yellen observed, "The events of the crisis demanded action, needed reforms were implemented, and these reforms have made the system safer."[19] Outgoing Federal Reserve Vice Chair Stanley Fischer warns against rolling back regulations. "It took almost 80 years after 1930 to have another financial crisis that could have been of that

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[16] Ryan Tracy, *U.S. Banking Industry Annual Profit Hit Record in 2016*, THE WALL STREET JOURNAL, (February 8, 2017), https://www.wsj.com/articles/u-s-banking-industry-annual-profit-hit-record-in-2016-1488295836.

[17] Yalman Onaran, *U.S. Mega Banks Are This Close to Breaking Their Profit Record,* BLOOMBERG MARKETS*, (*July 21, 2017, https://www.bloomberg.com/news/articles/2017-07-21/bank-profits-near-pre-crisis-peak-in-u-s-despite-all-the-rules.

[18] Thomas Hoenig, *Volcker Rule rollback is not the kind of reg relief small banks need,* AMERICAN BANKER (August 24, 2017) https://www.americanbanker.com/opinion/volcker-rule-rollback-is-not-the-kind-of-reg-relief-small-banks-need

[19] Janet Yellen, *Financial Stability a Decade after the Onset of the Crisis*, FEDERAL RESERVE, (August 25, 2017) https://www.federalreserve.gov/newsevents/speech/yellen20170825a.htm

magnitude." Going "go back to a status quo before the great financial crisis" would be "extremely dangerous and extremely short-sighted."[20]

Conclusion

As stated in the beginning, we believe the effort to dilute the Volcker Rule is dangerously misguided. In a letter to Treasury Secretary Steven Mnuchin, Sens. Sherrod Brown (D-Ohio) and Jeff Merkley (D-Oregon) wrote, "Given the strong evidentiary basis for the Volcker Rule, and the lack of empirical evidence that it is causing any harm to the Main Street economy, we urge you to join us in rejecting this unnecessary, costly, and disruptive re-litigation of the final Volcker Rule. That a joint rulemaking has been reopened by an acting agency head who has never been confirmed by the United States Senate, and who only recently represented in private practice the very institutions he now regulates, is inappropriate."[21]

We agree with these senators and regulators that the Volcker Rule should not be diluted. We believe it should be strengthened. We believe trading results should be made transparent to all so the public can understand enforcement. Banks should not gamble with taxpayer-backed deposits, but focus on the productive application of these funds to useful enterprise.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org, or 202.580.5626.

Sincerely,

Lisa Gilbert, Vice President of Legislative Affairs

Bartlett Naylor, Financial Policy Advocate

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[20] Karen Gilchrist, *Plans to unwind banking regulation 'very, very dangerous,' says Fed's Fischer*, CNBC (August 17, 2017) https://www.cnbc.com/2017/08/16/fed-fischer-plans-to-unwind-banking-regulation-very-dangerous.html
[21] *Letter to Treasury Secretary Steven Mnuchin,* SENS. SHERROD BROWN, JEFF MERKLEY (Sept. 7, 2017)